Over-reliance on land development revenue

Risky financing schemes

Unsustainable and Intractable employee compensation, especially public safety pension and retiree health care

Unsustainable Decline in Core Revenues

Ceding of management and policy choices to others

Fear & Denial

Toxic relationships

Hot Topics ‘n Burning Issues
A City Finance Update

CSMFO Channel Counties Chapter
June 5, 2014 Camarillo, CA

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Calif Society of Municipal Finance Officers
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The California Local Government Finance Almanac
Revenues are up $2.4 billion (one time – not ongoing...)
- PIT withholdings, partnerships, dividends
- re annual bonus payments & 2012 federal tax policy changes

... but higher costs already eat it up
- MediCal enrollment in FY15 to 11.5 million up from 7.9 million
  - 46% increase – now 30% of population in MediCal
  - $2.4 billion higher costs – but federal gov’t pays half
- Drought $800+ million
- Prop98 $659 million (net)
- CalPERS mortality assumptions, etc. - $1b phased in over 3 yrs
- Courts +$60 million to $160 million increase
Governor’s Proposed Budget

2014-15 Governor’s Budget
General Fund Budget Summary
($ in millions) Governor’s May Revision 2014

<table>
<thead>
<tr>
<th></th>
<th>2013-14</th>
<th>2014-15</th>
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</thead>
<tbody>
<tr>
<td><strong>Resources</strong></td>
<td></td>
<td></td>
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<tr>
<td>Prior Year Balance</td>
<td>$2,429</td>
<td>$3,903</td>
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<tr>
<td>Revenues and Transfers</td>
<td>$102,185</td>
<td>$105,346</td>
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<tr>
<td>Total Resources Available</td>
<td>$104,614</td>
<td>$109,249</td>
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<tr>
<td><strong>Expenditures</strong></td>
<td></td>
<td></td>
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<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$57,980</td>
<td>$63,304</td>
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<tr>
<td>Proposition 98 Expenditures</td>
<td>$42,731</td>
<td>$44,462</td>
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<td>Total Expenditures</td>
<td>$100,711</td>
<td>$107,766</td>
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<tr>
<td><strong>Fund Balance</strong></td>
<td>$3,903</td>
<td>$1,483</td>
</tr>
<tr>
<td>Economic Recovery bonds – early repayment (triple flip)</td>
<td>$1,604</td>
<td></td>
</tr>
</tbody>
</table>

California State Budget Outlook

Voter Approved Revenues

- Personal Income Tax (Prop30)
- Sales and Use Tax (Prop30)
- Corporate Tax simplification (Prop39)
Governor’s Proposed Budget
State General Fund and Realignment Fund Revenue
2014-15

- Personal Income Tax: $69,764, 59%
- Corporation Tax: $8,910, 8%
- Sales & Use Tax: $23,823, 20%
- Insurance Tax: $2,382, 2%
- Other/Transfers: $1,597, 1%
- Vehicle License Fee: $2,071, 2%
- Realignment Sales Tax: $9,569, 8%
- May Revision

Governor’s Proposed Budget
State General Fund and Realignment Fund Expenditures
2014

- K-12 Education: $44,743, 38%
- Health & Human Svcs: $29,633, 25%
- Mental Health, Support Svcs: $9,330, 8%
- Law Enforcement, Trial Court: $2,296, 2%
- General Govt: $3,485, 3%
- Resources & Environment: $2,321, 2%
- Transporation: $216, 0%
- BusnConsSvcsHsg: $745, 1%
- Legisl Judicial Exec: $2,919, 2%
- ERB Payment: $1,604, 1%
- May Revision

“Local Revenue Fund”
California’s Fiscal Outlook

Risks

- **Threat of Recession.** It’s inevitable.
- **Federal Challenges**
  - 2 year delay in prison population cap OK
  - Avoided debt ceiling problems
- **Health Care Costs.** Medi-Cal is budget’s 2nd largest program.
- **Natural Disasters:** draught, fires, flood, earthquake.
- **Debts and Liabilities.** In addition to budgetary debt:
  - $218 billion state retirement-related unfunded liabilities
  - $65 billion deferred maintenance
  - $9 billion unemployment insurance
- **Capital Gains** (10% of General Fund tax revenues) volatile, affected by stock market behavior.

Governor’s Proposed Budget 2014-15

**Reserves, Rainy-Day Funds**
- 2014-15 would end w/ $2.3 billion reserve (incl $1.6 bil in Prop58 resv)
- Proposes new rainy–day fund mechanism

**Education**
- K–12 schools +$4.5 billion
- Community Colleges +$355 million
- UC and CSU + $142 million each
- Higher Ed Innovation grants +50 million

**Also...**
- Judiciary and Criminal Justice + $105 million ongoing
- State employees +2% pay $173 million (all funds)

**Pay Down “Wall of Debt”**
- Accelerate pay down of economic recovery bonds $1.6 billion
- Pay off school and community college deferrals +$6.2 billion
- Repay $1.6 bil in special fund loans
- Address CalSTRS retirement liabilities

**Infrastructure, etc**
- Deferred maintenance projects +$815 million (one-time)
- Water Plan +$618 million plan incl groundwater basin protection, local water supplies, flood protection.
- Cap–and–Trade $850 million incl: high–speed rail system +$250 million, low–emission veh progr +$200 million
Managing California’s Debts
LAO: “California’s Key Liabilities”

3 Kinds of Debt
- **Retirement**: providing for employee pensions, healthcare
- **Infrastructure**: borrowing to fund major public facilities
- **Budgetary Debt**: borrowing to fund current services

**State’s Key Liabilities (debts) total over $340 billion**
- But state is addressing $140+ billion of that

**Unpaid debts (liabilities) grow at different rates**
- State should put retirement debt at top of priority list

---

**Examples of Growth Rates for Key Liabilities**

<table>
<thead>
<tr>
<th>Liability</th>
<th>Growth Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>7.5%</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>4.3%</td>
<td>$64.6</td>
</tr>
<tr>
<td>Special Fund loans to the General Fund</td>
<td>0.7%</td>
<td>$4.5</td>
</tr>
<tr>
<td>Mandate reimbursements to local gov’t</td>
<td>0.3%</td>
<td>$1.9</td>
</tr>
<tr>
<td>Proposition 98 settle-up</td>
<td>0.0%</td>
<td>$1.5</td>
</tr>
</tbody>
</table>

**Unfunded Retirement Obligations**

<table>
<thead>
<tr>
<th>Liability</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CalSTRS pension program</td>
<td>$73.7</td>
</tr>
<tr>
<td>Retiree health benefits for state employees</td>
<td>$64.6</td>
</tr>
<tr>
<td>UC pension &amp; retiree healthcare</td>
<td>$26.3</td>
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<tr>
<td>Judges’ Retirement System I pension program</td>
<td>$3.3</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$(167.9)</td>
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</table>

*Source: LAO*
### Eliminating the “Wall of Debt” Budgetary Debt

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Deferred payments to schools and community colleges</td>
<td>$10.4</td>
<td>$6.4</td>
<td>$6.1</td>
<td>$0.0</td>
<td>$0.0</td>
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<td>Economic Recovery Bonds</td>
<td>7.1</td>
<td>5.2</td>
<td>3.9</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Loans from Special Funds</td>
<td>5.1</td>
<td>4.9</td>
<td>3.9</td>
<td>2.9</td>
<td>0.0</td>
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<tr>
<td>Unpaid mandated costs to local govts, schools, colleges</td>
<td>4.3</td>
<td>4.9</td>
<td>5.4</td>
<td>5.4</td>
<td>0.0</td>
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<tr>
<td>Underfunding of Proposition 98</td>
<td>3.0</td>
<td>2.4</td>
<td>2.4</td>
<td>1.8</td>
<td>0.0</td>
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<tr>
<td>Borrowing from local governments (Proposition 1A)</td>
<td>1.9</td>
<td>1.1</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
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<tr>
<td>Deferred Medi-Cal Costs</td>
<td>1.2</td>
<td>2.0</td>
<td>1.8</td>
<td>1.7</td>
<td>0.0</td>
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<tr>
<td>Deferral of state payroll costs from June to July</td>
<td>0.8</td>
<td>0.7</td>
<td>0.8</td>
<td>0.8</td>
<td>0.0</td>
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<tr>
<td>Deferred payments to CalPERS</td>
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<td>0.4</td>
<td>0.4</td>
<td>0.4</td>
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<tr>
<td>Borrowing from transportation funds (Proposition 42)</td>
<td>0.4</td>
<td>0.4</td>
<td>0.2</td>
<td>0.1</td>
<td>0.0</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>$34.7</strong></td>
<td><strong>$28.2</strong></td>
<td><strong>$24.9</strong></td>
<td><strong>$13.1</strong></td>
<td><strong>$0.0</strong></td>
</tr>
</tbody>
</table>

Source: Governor’s Proposed Budget May Revision

**City/County mandate cost repayment:**
- 2014-15 $100m**
- 2015-16 $648m
- 2016-17 $152m

---

### Governor’s Proposal for Rainy Day Reserves

**Proposition 58 (2004)**
- Requires 3% of estimated General Fund revenues deposited to Budget Stabilization Account (BSA)
- Deposits continue until BSA reaches $8 billion or 5%.
- Half of BSA deposit repays Economic Recovery Bonds (ERBs) until repaid.
  - Used ‘06-07 & ‘07-08, then emptied.
  - Suspended each year since then.

**New Consensus Proposal**
- Annual required deposit - size based on capital gains income tax revenues over 8.0% of annual General Fund revenues plus 1.5% of General Fund Revenues.
- Fill to 10% of General Fund.
- Proposition 98 component:
  - amt counts for current year guarantee - to be used when guarantee drops.
- May use half to pay down debt.
Governor’s Proposed 2014-15 Budget Local Government Issues

- Supplemental Frontline Law Enforcement funding increased to $40 million** from $27.5 million (began in 2012 with Prop30)
- State law enforcement grant program continued.
  (since 2011 funded from VLF shifted from cities)
  - COPS Frontline Law Enforcement program at same level (SLESA)
  - Jail Detention Facility Grants (in lieu of booking fees)
- Insufficient ERAF compensation for cities/counties in Alpine, Amador, San Mateo. (re triple flip, VLF swap)
- State-County Assessors’ Partnership Agreement Program.
  - Three year program, $7.5 million/yr for nine chosen counties with matching funds to catch-up on property assessment.
- $3.3 million for public libraries for equipment to access high-speed internet networks.

Infrastructure Financing District Proposal

“Given that current compliance with the RDA dissolution statutes is improving, the Budget proposes expanding the IFD tax increment financing tool.”

- Expand IFD use to military base reuse, urban infill, transit priority projects, affordable housing, related consumer services. Goal: “Maintain focus on projects with benefits for residents of the IFD project area.”
- Create IFD, issue related debt subject to 55% voter approval.
- City or county may access its PropTaxInLieuVLF for IFD**
- Allow new IFD project areas to overlap with the project areas of the former RDAs.
- No tax revenues from K-14 schools, no state impact.
- Any participating county, cities, and special district that would contribute their revenue, must approve.
- Must have RDA Finding of Completion, compliance with SCO audit findings, conclusion of any outstanding legal issues.
A brief history of the Car Tax (VLF)

- 1935 – State Vehicle License Fee (a tax) established
  - motor vehicles eliminated from the local property tax
  - revenue subvened to cities and counties
- 1981-84 – State budget trouble. Legislature diverts hundreds of millions of city & county VLF
- 1986 – Prop47: VLF must go to cities and counties
  - but Legislature still decides the rate, the tax base and the allocation
- 1998 - Legislature & Gov Wilson pass VLF cut
  - with backfill for cities and counties
- 2003 – Gray Davis admin pulls trigger, raises VLF
- 2004 – Davis Recalled, Schwarzenegger elected
  - On his first day in office, Schwarzenegger cuts VLF - restoring backfill and punching a $4 billion ongoing hole in the state budget without any way to pay for it.
A Little History... VLF Revenues and Allocations

- VLF Backfill
- VLF Revenue at 0.65% rate
- Special Allocations
- Counties Per Capita
- Cities Per Capita
- Admin Charges
- H&W Realignment

Property Tax in lieu of VLF (2004 on)

The VLF-Property Tax Swap of 2004

- State General Fund
  - VLF Backfill
  - Cities & Counties
    - Property Tax in Lieu of VLF
  - Schools

* in FY2004-05
The Lack of VLF Replacement Makes New Cities Fiscally Unviable

City of Jurupa Valley General Fund

<table>
<thead>
<tr>
<th>Millions</th>
<th>If incorporated before 2004 swap</th>
<th>After Swap</th>
<th>w/AB1602 VLF patch (assumed in incorp process)</th>
<th>Actual (after SB89 shift)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VLF</td>
<td>$0.0</td>
<td>$0.0</td>
<td>$0.0</td>
<td>$0.0</td>
</tr>
<tr>
<td>Other</td>
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</tr>
<tr>
<td>SalesTax</td>
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<tr>
<td>Property Tax</td>
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<td></td>
</tr>
<tr>
<td>Franchise Fees</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Licenses/Permits</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If incorporated before 2004 swap

The Lack of VLF Replacement Makes many Annexations Fiscally Unviable

Annexation of Inhabited Area example

<table>
<thead>
<tr>
<th>Millions</th>
<th>If incorporated before 2004 swap</th>
<th>w/AB1602 VLF patch (assumed in annex process)</th>
<th>Actual (after SB89 shift)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VLF</td>
<td>$0.0</td>
<td>$0.0</td>
<td>$0.0</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
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<tr>
<td>SalesTax</td>
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<tr>
<td>Property Tax</td>
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<tr>
<td>Franchise Fees</td>
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<tr>
<td>Licenses/Permits</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Ending the Triple Flip

Can we stick it?

The Triple Flip

property tax for sales tax

- Increase State Sales Tax Rate +0.25%
- Decrease Local Sales Tax Rate -0.25%

Cities & Counties

Property Tax in Lieu of Sales Tax

State Fiscal Recovery Fund

State General Fund

Schools

$1.4 b

$1.4 b

$1.4 b
Triple Flip Timing
City/County Sales Tax Compensation

Fiscal Year
May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | May


The Triple Flip

- **Expected to end in 2015-16**
  - From debt service from ¼% state sales tax
  - Likely residual wind-down into 2016-17
- **Governor proposing addt’l $1.6 billion** payment from general fund in FY2014-15
  - Would end the Triple Flip in 2014-15 with residual effects into 2015-16.
- **Prop1A (2004) prevents any mischief**
- **One time boost of revenue for cities & counties at end**
  - Equivalent to 1.5 months of your sales tax
H.U.T.A. Headaches
The Fuel Tax Swap of 2010

California Sales Tax allocation before 2010

- State Sales Tax 5% of sale
- City/County 1¢
- County Transportation ¼¢
- County Health/Welfare ½¢
- Prop172 PublSafety ½¢
- Add-on - varies
Motor Vehicle Fuel Taxes
before 2010

Under Proposition 42 (2002), the state sales tax rate on gasoline and diesel is dedicated to transportation.

Motor Vehicle Fuel Taxes
before 2010

state portion
Motor Vehicle Fuel Taxes

**before 2010**

- **State Sales Tax**: 5% of sale
- **Base Fuel Excise Tax**: 18¢/gal

**Revenues**

$0

$1

$2

$3

$4

$5

$6

**Allocation**

- Public Transit Acct
- Prop42 Transit Acct
- Prop42 State Hwy Acct
- Prop42 City&Co
- State Highway Acct
- City&Co HUTA

Motor Vehicle Fuel Taxes

**Fuel Tax Swap of 2010**

- **Swap Excise Tax**: 21.5¢/gal (variable)
- **Base Fuel Excise Tax**: 18¢/gal

**Revenues**

$0

$1

$2

$3

$4

$5

$6

**Allocation**

- Public Transit
- State Transportation Debt Service
- State Highway Acct
- City&Co $2103
- State Highway Acct
- City&Co HUTA
Highway User Tax Revenues

Allocation

- **39.5¢** Per Gal Gasoline
- **18¢** base rate
- **21.5¢** Swap rate (varies)

Transportation Debt Service
State General Fund Relief

Weight Fees ~$900 million

State Highway Account
- **44%**

Counties
- **22%**

Cities
- **22%**

Remainder
- **22%**

Str&Hwys §§2104-2108

Str&Hwys §2103

Highway User Tax Revenues

FY10-11 FY11-12 FY12-13 FY13-14 FY14-15

- **§2103** swap HUTA cities & counties
- **§2104** counties
- **§2105** cities & counties
- **§2106** cities & counties
- **§2107** cities

Millions

June 5, 2014

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